



VIRGINIA LOTTERY

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2015

Auditor of Public Accounts
Martha S. Mavredes, CPA

www.apa.virginia.gov

(804) 225-3350



AUDIT SUMMARY

Our audit of the Virginia Lottery for the year ended June 30, 2015, found:

- the financial statements are presented fairly, in all material respects;
- internal control findings requiring management's attention; however, we do not consider them to be a material weakness; and
- instances of noncompliance required to be reported under Government Auditing Standards.

We have audited the basic financial statements of the Virginia Lottery as of and for the year ended June 30, 2015, and issued our report thereon, dated September 9, 2015. Our report is included in the Virginia Lottery's Annual Report that it anticipates releasing in December 2015.

–TABLE OF CONTENTS–

	<u>Pages</u>
AUDIT SUMMARY	
INTERNAL CONTROL AND COMPLIANCE FINDING AND RECOMMENDATION	1
STATUS OF PRIOR YEAR RECOMMENDATION	2
INDEPENDENT AUDITOR’S REPORT	3-5
AGENCY RESPONSE	6-7
AGENCY OFFICIALS	8

INTERNAL CONTROL AND COMPLIANCE FINDING AND RECOMMENDATION

Improve Capital Asset Management

The Virginia Lottery (Lottery) is not always properly managing and accounting for capital assets. During our audit we found that Lottery did not properly conduct full physical capital asset inventories, and the capital assets policies and procedures over inventory do not specify unique inventory procedures for some departments. As a result, we noted instances of misclassified capital assets, instances of assets not removed from the accounting system in a timely manner, and instances of assets in the system without a unique identifier. We also noted that the useful life assigned to asset categories had not been re-evaluated and assets remained in service after they were fully depreciated.

The Commonwealth Accounting Policies and Procedures (CAPP) Manual Topic 30000 outlines procedures and requirements related to fixed asset accounting, which includes specific requirements related to physical inventory, useful life, additions, renovations and repairs, software and other intangible assets, disposal management, and surplus property management. Without proper controls over capital assets, there is risk that the financial statements do not accurately reflect the true value of Lottery's capital assets.

Lottery manages capital asset inventory at the department level and each department submits inventories to the finance department when they are performed. Current Lottery capital asset policies and procedures are minimal, and Lottery is not consistently following procedures that do exist. In addition, departments do not consistently notify the finance department to update or remove assets in the financial system.

Lottery management should improve capital asset policies and procedures and implement additional procedures over physical inventory, asset classification, asset removal, asset identifiers, and useful life. Lottery should ensure that assets are capitalized properly, disposed of, and removed from the financial system timely, and that useful lives are being appropriately evaluated and changed.

STATUS OF PRIOR YEAR RECOMMENDATION

Improve End User Computer Controls

The Virginia Lottery (Lottery) does not use the principle of least privilege to restrict permissions for end user computers, in accordance with the Commonwealth's Security Standard, SEC 501-09, as reported in our previous audit. Allowing excessive computer permissions increases the risk that malware is unintentionally downloaded and installed on employees' computers. Once installed, this malware may propagate throughout Lottery's internal computers and can make them unavailable. Certain malware is also designed to collect information processed on infected computers and send it to a server outside the organization, thereby making the confidential data available to unauthorized entities. While Lottery is running a mature information security program, this finding weakens the layered information security controls protecting confidential and mission critical agency data.

We previously communicated the details of this finding to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia, due to their sensitivity and description of security controls.

We obtained a status update from the Lottery on the corrective actions related to this finding. As of our report date, corrective actions remain ongoing and we will review the implementation of management's corrective actions during our next audit.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

September 9, 2015

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John C. Watkins
Chairman, Joint Legislative Audit
And Review Commission

Virginia Lottery Board
Virginia Lottery

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, the financial statements of the **Virginia Lottery** as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise Virginia Lottery's basic financial statements, and have issued our report thereon dated September 9, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Virginia Lottery's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Virginia Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Virginia Lottery's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and

corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. We did identify certain deficiencies in internal control over financial reporting entitled “Improve Capital Asset Management” and “Improve End User Computer Controls,” which are described in the sections titled “Internal Control and Compliance Finding and Recommendation” and “Status of Prior Year Recommendation,” that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Virginia Lottery’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the sections titled “Internal Control and Compliance Finding and Recommendation” and “Status of Prior Year Recommendation” in the findings entitled “Improve Capital Asset Management” and “Improve End User Computer Controls.”

The Virginia Lottery’s Response to Findings

We discussed this report with management at an exit conference held on November 23, 2015. The Virginia Lottery’s response to the findings identified in our audit is described in the accompanying section titled “Agency Response.” The Virginia Lottery’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Status of Prior Findings

The Virginia Lottery has not taken adequate corrective action with respect to the previously reported finding “Improve End User Computer Controls.” Accordingly, we included this finding in the section entitled “Status of Prior Year Recommendation.”

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Audit Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

AUDITOR OF PUBLIC ACCOUNTS

AVC/alh



December 1, 2015

Martha S. Mavredes, CPA
The Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Dear Ms. Mavredes,

The following is the Lottery's response to the issues included as Internal Control Findings for the 2015 fiscal year audit.

Improve Capital Asset Management

The Lottery owns and manages capital fixed assets mainly comprised of equipment used in retailer locations to sell Lottery products, vehicles, information technology infrastructure equipment and intangible property including information technology systems. We believe that significant controls exist to assure that assets are fairly stated and controlled, but certainly acknowledge that additional enhancements would increase that assurance. The net financial value of capital assets is \$6.5 million, or two percent of the total lottery assets. We would also note the following additional information:

- Only one area within the Lottery was considered to have not conducted a full inventory of all assets, involving telecommunications assets. The Lottery considers that a full inventory of this area was completed; however, we do agree that inventory procedures did not describe the methodology for conducting this inventory. Methods other than a 100% physical "hands on" inventory were utilized to verify whether assets were considered to be in inventory.
- Two assets totaling just over \$40,000 were misclassified and should have been either expensed or classified as intangible software.
- Out of nearly 1,900 assets, 50 were not removed from the asset records timely after they were physically disposed of; all but two were fully depreciated. The financial impact of removing these assets was less than \$2,000.
- The period assigned to an asset class as "useful life" was often understated – meaning that fully depreciated assets remained in service. This practice is a conservative approach, since the full expense is depreciated more quickly. The objective was to ensure that assets were fully depreciated prior to being removed from service.

In response, the Lottery will implement the following enhancements to its capital asset management practices:

- Update Inventory Policies and Procedures for all areas within the Lottery, to include a responsible position within each area, along with unique inventory procedures.
- Review and evaluate the useful life of assets every two years, using an asset group formula to evaluate the lives of the groups.

we're game

- Implement enhanced inventory control and tracking capabilities that may be available in the new general ledger system. For example, photographs of assets or GPS coordinates may be able to be used to assist with asset control and tracking, especially where serial numbers and other unique identifiers are not available or useful.
- Continue to coordinate with the surplus property coordinator, as well as the responsible position in the inventory areas, to help ensure complete and timely information and updates to the fixed asset records for disposed assets.

Improve End User Computer Controls

The Virginia Lottery remains committed to addressing this concern, and continues to progress with the action plan developed last year to advance our efforts in this area in a controlled fashion. Incremental milestones continue to be met in accordance with the overall plan.

Thank you for your continued professionalism and comprehensive audit activities to help ensure the overall integrity of Lottery operations and financial reporting.

Sincerely,



Paula I. Otto

AGENCY OFFICIALS

VIRGINIA STATE LOTTERY DEPARTMENT

As of June 30, 2015

Paula I. Otto
Executive Director

BOARD MEMBERS

As of June 30, 2015

Fred P. Helm
Chairman

Kevin D. Smith

Robert M. Howard

Cynthia D. Lawrence

Albert H. Poole